DEPARTMENT OF STATE REVENUE

04-20170966R.MOD

Memorandum of Decision 04-20170966R
Gross Retail Tax
For the Year 2017

NOTICE: IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Memorandum of Decision.

HOLDING

Waste Disposal Company was entitled to a refund of sales tax paid on the purchase of natural gas because Waste Disposal Company established it was in the business of providing public transportation.

ISSUE

I. Gross Retail Tax - Public Transportation Exemption.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-3-4; IC §§ 6-2.5-5-1 to 46; IC § 6-2.5-4-1(b), (c); IC § 6-2.5-5-27; *Wendt LLP v. Indiana Dep't of Revenue,* 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Carnahan Grain, Inc. v. Indiana Dep't of State Revenue*, 828 N.E.2d 465 (Ind. Tax Ct. 2005); *Rhoade v. Indiana Dep't of State Revenue*, 774 N.E.2d 1044, (Ind. Tax Ct. 2002); *Panhandle Eastern Pipeline Co. v. Indiana Dep't. of State Revenue*, 741 N.E.2d 816 (Ind. Tax Ct. 2001); *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466 (Ind. Tax Ct. 1993); *Indiana Dep't. of State Revenue v. Calcar Quarries, Inc.*, 394 N.E.2d 939 (Ind. Ct. App. 1979); *Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); 45 IAC 2.2-5-61; 45 IAC 2.2-5-61(j); Sales Tax Information Bulletin 12 (July 2015); Sales Tax Information Bulletin 12 (September 2014).

Taxpayer argues that it is entitled to a refund of sales tax paid on the purchase of natural gas on the ground that compressed natural gas is used in its vehicles providing public transportation and was paid to do so.

STATEMENT OF FACTS

Taxpayer is an Indiana company in the business of providing waste disposal and recycling services. Taxpayer purchases natural gas which it uses as fuel in its transport vehicles. On the ground that it is in the business of transporting goods which it does not own and is paid to do so, Taxpayer submitted a Claim for Refund (GA-110L) seeking a refund of approximately $15,000 of sales tax paid at the time it purchased the natural gas.

The Indiana Department of Revenue ("Department") denied the refund claim because Taxpayer was "not paid to haul."

Taxpayer disagreed with the decision and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Memorandum of Decision results.

I. Gross Retail Tax - Public Transportation Exemption.

DISCUSSION

The issue is whether Taxpayer has provided sufficient information to establish that it is in the business of providing public transportation. The Department found that Taxpayer was not in the business of providing *public* transportation because it was not paid to provide those services.

Taxpayer disagrees and explains that the natural gas it purchases "is converted to Compressed Natural Gas . . . which is used as fuel to power the operations of solid waste & recycling collection motor vehicles." Taxpayer further explains that its motor vehicles "are used on highways and provide for the public transportation of property." As authority for its position, Taxpayer cited to IC § 6-2.5-5-27 which provides as follows:

> (a) Except as provided in subsection (b), transactions involving tangible personal property and services are

exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

(b) Except as provided in subsection (c), a transaction involving a natural gas product (as defined by IC 6-6-2.5-16.5) acquired:

(1) after December 31, 2013, and before January 1, 2017; and

(2) to fuel a motor vehicle used in providing public transportation for persons or property;

is not exempt from the state gross retail tax.

(c) Subsection (b) does not apply to transactions involving a natural gas product purchased by a public transportation corporation to fuel a motor vehicle used to provide public transportation for persons.

As to IC § 6-2.5-5-27(b), the Department's Sales Tax Information Bulletin 12 (July 2015), 20150729 Ind. Reg. 045150221NRA; explains that "After Jan. 1, 2017, the exemption for natural gas products purchased by providers of public transportation and used to provide public transportation of persons or property [was] reinstated."

As more specific authority for its decision that Taxpayer was not entitled to the exemption, the Department relied on Sales Tax Information Bulletin 12 (July 2015), *See also* Sales Tax Information Bulletin 12 (September 2014), 20150128 Ind. Reg. 045150028NRA. The Bulletin provides:

The following requirements are factors the department weighs in determining whether a transportation company is engaged in public transportation. An asterisk (*) indicates a requirement that is considered by the department to be a critical factor in determining whether a transportation company qualifies for the public transportation exemption. A transportation company fails to qualify for the exemption if it does not, at a minimum, adhere to all the critical requirements. However, failure to adhere to one or more of the "noncritical" requirements can also result in a transportation company's failure to qualify for the exemption. The requirements are:

- The transportation company must transport the persons or property of another.*
  - The transportation company must maintain all shipping/transporting documents for all transactions (e.g., trip reports, truck logs, and invoices).*
- The transportation company must receive compensation for the services it provides.*
- The transportation company must hold and pay for appropriate public transportation insurance.*
- The transportation company must be fully and independently authorized by federal and/or state authorities to provide public transportation services.*
- If an employee of the parent company performs duties for the parent company and also performs "leased" duties for the transportation company, the parent company must maintain detailed records of when and which duties that employee is performing for the parent company and when and which duties that employee is performing under the lease.*
- If the parent company makes a capital contribution of the vehicles to the transportation company, titles to the vehicles must be transferred to the transportation company.*
- The transportation company and the parent company must maintain separate books and records, including separate charts of accounts for each company:
  - Transactions between the parent company and the transportation company must evidence a commercially reasonable, arms-length relationship between the parties.
  - Transactions between the parent company and the transportation company must be evidenced by actual invoicing and payments for all transactions.*
  - The parent company and the transportation company must segregate and account for each entity's purchases and expenses.*
  - The parent company and the transportation company must maintain separate bank accounts.
  - The parent company and the transportation company must issue separate W-2 forms to their employees.
  - The parent company and the transportation company must maintain separate federal depreciation schedules pursuant to generally accepted accounting standards.
  - Any income earned by the transportation company for transporting for a third party is to be recognized by the transportation company.
  - Because the transportation company and the parent company must have a distinct, arms-length business relationship, their separate incomes and expenses must be reflected on the taxpayers' federal income tax filings, all of which must be reconciled with the taxpayers' own records. When transactions

are eliminated as intercompany transactions, the taxpayers must file the appropriate schedules with their federal returns.*

- If the parent company owns and holds titles to the vehicles, the parent company may lease those vehicles to the transportation company. However:
  - The lease must be documented as a commercially reasonable, arms-length transaction; and
  - The lease must be evidenced by actual payments to the parent company.
- If the transportation company owns the vehicles, titles to the vehicles must be held by the transportation company.
- The parent company and transportation company must have separate employees, or, if the transportation company leases its employees from the parent company, there must be a meaningful, arms-length charge for the leased employees.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. *See Rhoade v. Indiana Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. *Id*.; *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466, 468-69 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. *Id*. A taxable retail transaction occurs when (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. *See* IC § 6-2.5-1-2; IC § 6-2.5-4-1(b), (c); IC § 6-2.5-3-2(a).

In general, all purchases of tangible personal property are taxable unless specifically exempt by statute. 45 IAC 2.2-5-61(j). An exemption from use tax is granted for transactions where the sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4. There are also additional exemptions from sales tax and use tax under IC §§ 6-2.5-5-1 to 46. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id*. at 101.

IC § 6-2.5-5-27 states:

> Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

45 IAC 2.2-5-61, in relevant part, provides:

> (a) The state gross retail tax shall not apply to the sale and storage or use in this state of tangible personal property which is directly used in the rendering of public transportation of persons or property.
> (b) Definition: Public Transportation. Public transportation shall mean and include the movement, transportation, or carrying of persons and/or property for consideration by a common carrier, contract carrier, household goods carrier, carriers of exempt commodities, and other specialized carriers performing public transportation service for compensation by highway, rail, air, or water, which carriers operate under authority issued by, or are specifically exempt by statute or regulation from economic regulation of, the public service commission of Indiana, the Interstate Commerce Commission, the aeronautics commission of Indiana, the U.S. Civil Aeronautics Board, the U.S. Department of Transportation, or the Federal Maritime Commissioner; however, the fact that a company possesses a permit or authority issued by the P.S.C.I., I.C.C., etc., does not of itself mean that such a company is engaged in public transportation **unless it is in fact engaged in the transportation of persons or property for consideration** as defined above.
> (c) In order to qualify for exemption, the tangible personal property must be reasonably necessary to the rendering of public transportation. The tangible personal property must be indispensable and essential in directly transporting persons or property. (**Emphasis added**).

In *Indiana Dep't. of State Revenue v. Calcar Quarries, Inc.*, 394 N.E.2d 939 (Ind. Ct. App. 1979), the taxpayer, Calcar Quarries, Inc. (Calcar), had multiple lines of business, including a stone quarry, a hot mix asphalt plant, and a ready mix concrete facility in Indiana. *Id*. at 940. After an audit, the Department determined that Calcar engaged primarily in the service of hauling its own product, and, thus, was not entitled to public transportation exemption on trucks and equipment it purchased or rented because it was not engaged in public transportation. *Id*. The Indiana Court of Appeals found that Calcar's trucks had been used for hauling property owned by others. *Id*. at 941. Additionally, the Court of Appeals also found that Calcar charged separately for the stone and maintained separate accounting records for its trucking operation from those of the quarry, asphalt, and ready mix operations. *Id*. The Indiana Court of Appeals further noted:

> [W]hen an item has been used for several purposes and only some of the purposes qualify the item for exemption, the taxpayer can gain exemption for the total amount of the purchase price of the item by showing that the item was used predominantly in an exempt manner.

Id. at 941 n.1.

The court of appeals concluded that Calcar demonstrated that it predominantly used the trucks and equipment in transporting property of others.

In *Panhandle Eastern Pipeline Co. v. Indiana Dep't. of State Revenue*, 741 N.E.2d 816 (Ind. Tax Ct. 2001), Panhandle Eastern Pipeline Co., and its subsidiaries (Panhandle) claimed that they were entitled to a 100 percent exemption of sales/use tax for equipment purchased and used in the distribution of natural gas, but the Department only granted a prorated exemption based on the actual amount of gas Panhandle publicly transported. *Id*. at 817. Ruling in favor of Panhandle, the Tax Court stated:

> [T]he public transportation exemption provided by section 6-2.5-5-27 is an all-or-nothing exemption. If a taxpayer acquires tangible personal property for predominate use in providing public transportation for third parties, then it is entitled to the exemption. If a taxpayer is not predominately engaged in transporting the property of another, it is not entitled to the exemption.

Id. at 819.

In *Carnahan Grain, Inc. v. Indiana Dep't of State Revenue*, 828 N.E.2d 465 (Ind. Tax Ct. 2005), the Department determined that, based upon total miles traveled for each of the audited years, the taxpayer, Carnahan Grain, Inc. (Carnahan), predominantly used the tractor-trailers and related equipment to haul property owned by third parties, but it received only approximately 22 percent of its total income from hauling property of others. Thus, the Department assessed Carnahan additional sales/use tax on the tractor-trailers and related equipment on the ground that, although Carnahan predominantly used the tractor-trailers for third-party hauling, it was not predominantly engaged as a business in hauling for third parties, pursuant to the two-prong test outlined in the *Panhandle Eastern Pipeline Co.* decision. *Id*. at 467. Rejecting the Department's "income" approach, the Tax Court explained the proper application, as follows:

> If [] the property is used predominantly for third-party public transportation, then the taxpayer is entitled to the exemption. Conversely, if the property is not predominantly used for third-party public transportation (*i.e.*, it is predominantly used to transport the taxpayer's own property), then the taxpayer is not entitled to the exemption.

Id. at 468.

Specifically, following the *Calcar* decision, the court in *Carnahan Grain* reasoned that "when an item has been used for several purposes and only some of the purposes qualify the item for exemption, the taxpayer can gain exemption for the total amount of the purchase price of the item by showing that the item was used predominantly in an exempt manner." *Id*. at 469 (quoting *Calcar*, 394 N.E.2d at 941 n.1). The Tax Court ruled in Carnahan's favor based upon miles the trucks traveled to conclude that Carnahan predominantly used the trucks to transport property of others and thus public transportation exemption applied to the trucks and related equipment. *Id*.

In *Wendt LLP v. Indiana Dep't of Revenue,* 977 N.E.2d 480 (Ind. Tax Ct. 2012), the taxpayer, Wendt LLP, was in the business of relocating oversized factory machinery, claiming that it was entitled to the public transportation exemption on its tangible personal property used in the course of its business. Following the rulings of *Panhandle Eastern Pipeline Co.* and *Carnahan Grain,* the Tax Court reiterated that "[t]he public transportation exemption is

all-or-nothing exemption" and this exemption requires "an item to be predominantly used, not exclusively used, in public transportation to be exempt." *Id*. at 484-85.

Accordingly, pursuant to the above-mentioned statutes, regulations, and case law, a taxpayer is entitled to the public transportation exemption on its purchase of an item only when the taxpayer demonstrates that the item is directly and predominantly used to transport property *of others for consideration*.

In effect, the statute, regulation, and case law direct that the exempt property must be predominately used by the purchaser to provide public transportation, that the business claiming the exemption must be transporting property belonging to others, and that the business must be compensated for doing so. In this case, the Department found that Taxpayer was not engaged in public transportation because - as explained in the Department's July 2017 denial - Taxpayer "is not paid to haul." As a result, Taxpayer - as the "transportation company" - fails one of the critical factors set out in Sales Tax Information Bulletin 12; "The transportation company [must] receive compensation for the services it provides." In effect, the rule is that if the transportation company is not being paid, the Department reasonably assumes that the company and its customer do not "evidence a commercially reasonable, arms-length relationship . . . ."

Taxpayer provided copies of the contracts it entered into with various customers. Those contracts establish that Taxpayer and its customers are related or associated companies which - standing alone - does not disqualify Taxpayer from claiming the public transportation sales tax exemption.

On their face, the Taxpayer/customer agreements exhibit indicia of an "arm's-length" transaction. The agreements contain a provision specifying "rates and charges" charged customers; agreements specify that Taxpayer hold and pay for "appropriate public transportation insurance." However, the sole issue here is whether Taxpayer can establish that it was actually paid for providing the waste hauling services to its customers.

As to this dispositive issue, Taxpayer has provided copies of an invoice for approximately $16,000 issued to its related company customer. In turn, Taxpayer has provided a bank "transaction detail" documenting an internal bank transfer of the $16,000 amount from related customer to Taxpayer. According to Taxpayer, it was its regular practice to issue invoices to its related customers and for those customers to compensate Taxpayer by means of an "internal money transfer." The invoice provided is commensurate with the provisions set out in the agreements between itself and the related customer.

After reviewing the agreements between Taxpayer and its related customers and the evidence of the method by which Taxpayer is compensated for providing its transportation services, the Department is prepared to agree that Taxpayer has provided sufficient information justifying its argument that - for purposes of the cited tax exemption - Taxpayer is in the business of providing public transportation.

FINDING

Taxpayer's protest is sustained.

March 8, 2018

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